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By Amanda Radke

Should you really co-sign your farm kid's loan?

If avoiding the bank to obtain credit, family members should heed this advice when lending money to a loved one.

Amanda Radke | Aug 28, 2019

Nine years ago, at the ripe old age of 22 and 24 years old, Tyler and I — newly married with stars in our eyes — had the opportunity to purchase our dream acreage, which sat adjacent to my family's cattle ranch in South Dakota.

The only problem — well, we were young, broke and had yet to build good credit or a solid reputation with a lender.

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Now there are many schools of thought on whether the "bank of mom and dad" should step in when a situation like this arises. Here are a few options:

A. Do you as a parent, tell your child to wait and save a proper down payment before investing in a farm?

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B. Do you co-sign on a loan to help your child get on his or her feet? Perhaps you even offer up your own farm assets as collateral on the loan?

C. Do you go as far as to lend the down payment or purchase it yourself with the hopes that your adult child will pay you back in full and with interest in a timely fashion?

D. Do you gift a down payment as a wedding present and expect nothing in return?

In the case of our acreage, Tyler and I were able to come up with a down payment, but my parents graciously co-signed to secure the land loan until we were able to pay enough down to take over the loan independently a couple of years later.

Of course, this could have backfired greatly, and for many farming families , depending on whether you choose option A, B, C or D, the outcome could severely impact familial and business relationships moving forward.

Thankfully, we were determined young kids, and to be frank, co-signing the loan was a bit of an investment for Mom and Dad. After all, they now have a natural extension to the ranch, with the added benefits of more calving facilities, pastures and storage to utilize in our shared seedstock operation.

Fortunately for everyone involved in this scenario, it was a win-win situation that mutually benefited all parties. However, without their help (and the timely lingering recession and coinciding real estate crash that allowed us to purchase the property at a decent price), this acquisition would have never been possible for two young kids fresh out of college.

I hesitate to share personal stories like this; however, I believe in writing from a place of real-world experiences . In hindsight, my parents were probably crazy for trusting us kids! Now, that we are truly settled here and reaping the rewards of purchasing a land and home so close to the ranch site, I'm so thankful they did!

Without question, money is an awkward topic, but it's an important one. This is especially true in farming families where boundaries are often unclear, expenses and profits are shared and the line between business and family is blurred.

And while money may be an uncomfortable discussion, the reality is that this essential green paper is what makes or breaks a family operation.

Dr. David Kohl, a well-known agricultural economist, recently wrote about the topic of family lending in his August column for First Dakota National Bank.

Kohl writes, “An increasing number of young and beginning farmers and ranchers are obtaining their loans from the bank of mom and dad or extended family. Farms that are in financial stress frequently reach out to family members to bridge the financial gap.

“When and why do these private financing agreements fail? First, these agreements fail due to a lack of accountability. Private financing agreements are often settled with a hand shake or nod and are very emotionally driven decisions.

“While the willingness to provide financing is admirable, a written and defined payment plan needs to be developed and executed even with family members. In the event of financial adversity, many times private financiers are willing to delay payments or, in some cases, forgive debt.

“In other cases, the older generation has lost equity in their golden years as a result of assisting family members and not knowing the true financial picture. If the younger generation is required to seek financing with a traditional lender, then they can build a reputation to leverage for future growth and expansion. My overall advice for private financing would be to document the agreement in writing and verify a borrower’s situation before extending credit to family members.”

If you are considering lending money to a family within the

farming enterprise, there are a few things to keep in mind. An article titled, "Family Loans: How to Borrow and Lend with Family," written by Justin Pritchard for The Balance breaks it down.

Pritchard said to do it right, focus on three key areas: protecting relationships, financially protecting the lender (including any dependents or heirs) and staying out of trouble with the IRS.

Pritchard writes, "These loans need to end up in a win/win situation—a good deal for both the borrower and the lender—in order to keep your family intact. Lenders especially need to understand the risks, their motivation for lending, and the alternatives to making a loan.

"Generally, lenders want to help somebody they love—and that's a good start. But there are several other ways to help, including simply gifting the money and cosigning on a loan."

1. Gifting

Pritchard writes, "If you give the money to your family member with no expectation of getting repaid, things are much simpler. However, you might actually need that money someday, and you might want your family member to be responsible for their own expenses. That said, some people suggest that you should never lend to family unless you're (even in secret) OK with never getting repaid."

2. Cosigning

"You could also cosign a loan and help the borrower get approved," said Pritchard. "Your income and credit might be enough to do the trick.

However, your credit is at risk when you cosign, and you might not be willing to take that risk."

3. Collateral

"For the greatest protection, insist on using collateral to secure the loan," he advises. "This means you get to take possession of an asset (such as a house or car) and sell it to recover your money in a worst-case-scenario. Especially if you make a large loan for a home purchase, get a lien on the home to protect yourself."

4. Written agreements

"Use a written agreement to keep everybody on the same page, and to help ensure that the lender doesn't walk away empty-handed," he writes. "Local attorneys and online services can provide documents—make sure they're legal in your state."

To read the entire article , which includes information on tax laws, loan services, attorneys, building credit, protecting the borrower, lender and family relationship and more, click here.

The opinions of Amanda Radke are not necessarily those of beefmagazine.com or Farm Progress.